89-1781

No.

Supreme Court, U.S.
FILED
MAY 15 1990
JOSEPH F. SPANIOL, JR.
CLERK

IN THE
Supreme Court of the United States
October Term, 1989

Estate of JAMES MANNO and DOMINICK MANNO, doing business as ASTORIAN MANOR,

Petitioners,

vs.

STATE OF NEW YORK, STATE TAX COMMISSION,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK

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QUESTIONS PRESENTED

In this New York Sales and Use Tax audit of petitioners' catering business covering an original two year period, later extended, without underlying data, to cover an additional period of 1 year, 9 months, the State auditor found 175 persons for whom, unlike all the others making reservations in the Appointment Book neither receipted contracts kept in monthly folders, nor Appointment Book notations of cancellation could be found.

In direct unilateral interviews, the auditor succeeded in establishing contact with 160 of the 175. Fifty-five of the 160 advised the auditor that their affairs had been celebrated, that they had paid the price therefore since a final price in cash or certified check, payable at least 5 days before the affair, was required by management. Of these 55, 30 still had their receipted contracts which they sent in to the auditor.

The other 105 who had booked reservations were characterized by auditor, State Tax Commission and the New York Appellate Division as "uncooperative witnesses" because they refused to say anything in furtherance of the auditor's case. However the auditor, sustained by his administrative and judicial superiors, inferred or guessed from the silences of the 105 that none of them had denied that their affairs took place.

Auditor, administrative agency and Court have affirmed an assessment of sales tax covering all 175 events and extended the assessment to cover an additional period of 1 year, 9 months with penalties and interest for a taxable base of $827,078.

The questions follow:

1. Whether it was a violation of Fourteenth Amendment procedural due process on the part of the respondents in the course of a New York sales and use tax audit of petitioners' catering business not to give copies or access to petitioners of decisively important documentary items received by respondents' auditor on unilateral solicitation of petitioners' customers, where the documents, 30 receipted contracts hitherto missing, were they to be compared to the entries—not identified by customer names (Appendix 4, p.18a), but nevertheless

recording exact amounts and dates of receipt, banking dispositions and the like—in the vendors' Cash Receipts Journal, an admittedly reliable source for all of the data going into petitioners' sales and income tax returns, could well nigh conclusively show guilt or innocence on the part of the vendors? The auditor was familiar with the comparison test between receipted contracts and entries in the Cash Receipts Journal, having announced that all contracts previously in the folders matched to Cash Receipts Journal entries and had therefore been legitimately accounted for to the tax authorities, all without reference to the later received 30 receipted contracts. Neither auditor nor Tax Commission ever mentioned a comparison test with respect to these thirty contracts, and one can legitimatly wonder why it was not until nearly three years after the close of the audit that these 30 contracts were exposed and introduced into evidence.

2. Whether it was a violation of Fourteenth Amendment substantive due process with respect to the 105 interviewed witnesses, characterized by the auditor, Tax Commission and Appellate Division as "hostile", for respondents nevertheless to assess petitioners sales tax on the 105 based, not on any evidence in what these "hostile" witnesses said but rather on the auditor's unsupported, and unlikely, conjecture of what they were trying, by their silences, to conceal; silences from which he and the reviewing authorities over him agreed that these 105 "did not deny that the affair took place."? Thus the auditor testifying at the administrative hearing of December 3, 1986 with respect to the 105, all of whom had booked reservations and therefore knew perfectly well what he was talking about:

> "What it was, it was a response indicating that they did not want to get involved. People do not like to talk to the Tax Department. It would be normal for a person to say what affair. No one said that."(Record, p. 110).

Nothing by way of speech attributed to any of the 105, nothing by way of receipted contract, nothing by way of proof of payment for an affair reinforces this ghastly silence by which petitioners were assessed nearly 70% of the State's claim.

3. Whether it was not error, reviewable by this Court, as itself violative of Fourteenth Amendment procedual due process,

a) For the New York Court of Appeals to deny to petitioners in this case their right to an appeal as of right in the light of the substantial constitutional issues directly involved in the case; and

b) For the State of New York to contrive the trial of its Civil Practice Law and Rules, §§7803 (4), 7804 (g) cases following an administrative hearing to be transferred to the Appellate Division of its Supreme Court for trial or hearing before it sitting in original, rather than appellate jurisdiction so that litigants might be deprived thereby of their ordinary due process right to one trial and one appeal by truncating their right to appeal?

PARTIES

The caption of the case in this Court contains the names of all the parties to the proceedings in the States courts.

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Estate of JAMES MANNO and DOMINICK MANNO, doing business as ASTORIAN MANOR,

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STATE OF NEW YORK, STATE TAX COMMISSION,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK

Petioner prays that a writ of certiorari issue to review the final order herein of the Court of Appeals of the State of New York of February 20, 1990 which said order, *sua sponte,* dismissed the appeal herein taken to it as of right on the ground "that no substantial constitutional question is directly involved."

Reports of Opinions in the Case

1. Order of the Court of Appeals of the State of New York Dismissing the appeal herin on the ground that it does not directly involve a substantial constitutional question, February 20, 1990. —NY 2d—; —N.Y. Supp. 2d.—. (Appendix 1 hereto)
2. Opinion of the Supreme Court of the State of New York, Appellate Division, Third Department, dismissing the petition herein, February 9, 1989, 147 App. Div. 2d 805; 537 N.Y. Supp. 2d 683. (Appendix 2 hereto)
3. Decision of Respondent State Tax Commission modifying adiminstrative notices of tax determination, and otherwise denying administrative petition to review assessment of additional sales tax, June 18, 1987. Not officially reported, but a copy is set forth as Appendix 3 herein.

JURISDICTION OF THIS COURT HEREIN

The final judgment of the Court of Appeals of the State of New York dismissing the appeal taken to it as of right is dated and was entered February 20, 1990. No application for rehearing was made and neither has an application for extension of time been made.

Petitioners believe that this Court has jurisdiction to entertain this petition under 28 U.S.C. §1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Constitution of the United States
Fourteenth Amendment, section 1:

"*§1. Citizenship rights not to be abridged by states*

Section 1. All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws."

McKinney's Consolidated Laws of New York (Annotated) Civil Practice Law and Rules

"§5601. Appeals to the court of appeals as of right

****

"*(b) Constitutional grounds.* An appeal may be taken to the court of appeals as of right:

"1. from an order of the appellate division which finally determines an action where there is directly involved the construction of the constitution of the state or of the United States;"

"*§7803. Questions raised*

The only question that may be raised in a proceeding under this article are:

****

"4. whether a determination made as a result of a hearing held, and at which evidence was taken, pursuant to direction by law is, on the entire record, supported by substantial evidence."

"§ *7804 Procedure*

"*(a) Special proceeding.* A proceeding under this article is a special proceeding.

"(b) Where proceeding brought. A proceeding under this article shall be brought in the supreme court, special term, in the county specified in subdivision (b) of section 506 except as that subdivision otherwise provides.

****

"*(g) Hearing and determination; transfer to appellate division.* Where an issue specified in subsection four of section 7803 is not raised, the court in which the proceeding is commenced shall itself dispose of the issues in the proceeding. Where such an issue is raised, the court shall make an order directing that the proceeding be transferred for disposition to a term of the appellate division held within the judicial department embracing the county in which the proceeding was commenced; the court may, however, itself pass on objections in point of law. When the proceeding comes before it, whether by appeal or transfer, the appellate division shall dispose of all issues in the proceeding, or, it the papers are insufficient, it may remit the proceeding."

STATEMENT OF THE CASE

The fact development of this case and the due process questions which it raises stem from unilateral interviewing by the auditor of 160 persons who had booked affair reservations in petitioners' appointment book, but for whom neither receipted contracts, routinely kept loose leaf in monthly folders, nor red ink notations of cancellation of affairs, written over the original appointmentbook entries, could be found.

From all of the receipted contracts found in the folders, the

auditor attests, matching entries, by amounts and dates since there was no identification by customer name in the cash sales journal (Appendix 4, p.18a), were invariably found in that journal:

> "*** all contracts found in the monthly folder were found to be entered in the cash receipts book"***"(Field Audit Report, Sept. 18, 1984; App. 4, p. 18a)

The cash receipts journal was, in turn, the centrally reliable source for the data reported in tax and information returns going to both income and sales tax authorities, as well as banking ransactions and the like.

a) The case for violation of procedural due process concerns 55 interviewed customers who advised the auditor that their affairs had been consummated and paid for. Of these 30 still had their receipted contracts and forwarded them (or photocopies) to the auditor's affice. Had the auditor compared receipted contracts with the cash receipts journal as he had with the receipted contracts originally in the folders, he would have known the vendors' guilt or innocence at once; innocence because a matching receipted contract and its entry into the cash receipts journal would show proper recording in the accounting record with remittance and payment to the tax authorities, or guilt because the inability to find a matching entry in the cash receipts journal implies fraud and condealment on the part of the vendors. That the auditor was keenly aware of the critical nexus between the receipted contract and its entry into the cash receipts journal is attested by his Field Audit Report of September 18, 1984 Appendix 4; p.15a:

> "Vendor maintained a book captioned Cash Receipts, in actuality, it was a Sales Book. The amounts posted in this book came from contracts that were handed to the outside Junior Accountant by James Manno. Monthly totals were then posted to a General Ledger entitled Catering Income***
>
> "A schedule was prepared for the period March 1, 1980 through November 30, 1983, showing the monthly Liquor & Beer, Food and Hat Check and Misc. Amounts. The monthly figures were then totalled quartely and com-

pared to the gross sales reported on corresponding sales tax returns. ***All differences (although minor and insignificant) were reconciled. Note that vendor is a part-quarterly (monthly) filer.

"Gross sales per books, and sales tax returns were compared to Federal Income Tax Returns ***. Differences found were attributable to several items (income from cancelled contracts, from rentals and commissions) *not subject to sales tax* that were *not* included in the gross sales reported on the corresponding sales tax returns. However, since these items have income tax implications, they were properly included on the appropriate income tax returns." (emphasis supplied)

After all, it was the presence of receipted contracts with their exact amounts and dates of collection, and their implicit demand for entry into books of account and deposit of receipts into banks rather the ever varying estimated amounts and unpredictable dates of payment—if any—of the appointment book reservation, which rendered the former indispensible for conclusively matching tests with the cash receipts journal. The receipt, therefore, of so large a sample as 30 receipted contracts hitherto missing was a golden opportunity to make comfortably just disposition in the case. Assuming that the auditor had made an immediate comparison check upon receipt of these thirty customer-supplied receipted contracts with the cash receipts journal as he had routinely done with those that had not strayed from their monthly folders:

"*** The Audit Division examined sales contracts for the period March 1, 1982 through August 31, 1982. The contracts were compared with the cash receipts journal and the appointment book. This procedure revealed that all the contracts in the file were recorded in the cash receipts journal and cancelled contracts were indicated as such in the appointment book." Appendix 3, Decision of State Tax Commission, June 18, 1987, p.10a)

it becomes embarassingly difficult to explain why, had mismatch and vendor guilt been the result of his search, he should not have proclaimed his triumphant discovery and bring his case to an irrebuttable close.

Yet not only did the auditor keep the very existence of the 30 receipted contracts to himself through the balance of time when the audit was still under way and the cash receipts journal and other books of account were still readily available at a going place of business, he did not announce their existence until 6 months after the audit was complete and 4 months after James Manno, then the sole proprietor and possibly at that time the only highly involved individual with special knowledge of the significance of the relationship between the cash receipts journal and incoming payments with their receipted contracts, died of a heart attack (Field Audit Report, Sept. 9, 1984, Appendix 4, p. 19a).

But by far the worst offense against the plain and obvious requirements of procedural due process was the withholding by the auditor of photocopies of the 30 receipted contracts received by him early in 1984. Not until the administrative evidentiary hearing of December 3, 1986 were the 30 receipted contracts made available to representatives of the vendors (Record p. 61, Exh. J), and even here it took a good look rather than guesswork to determine that these "replies from the parties contacted" were indeed the 30 receipted contracts:

> "Mr. Palmer (for respondent)—May I have the documents in my hand as a group marked for identification, as State's Exhibit J.
>
> "HEARING OFFICER: This group of documents will be marked for identification, Exhibit J. (Group of documents marked State's Exhibit J for identification, as of this date).
>
> "Q. Mr. Safran, [State auditor] I show you what has been marked for identification as State's Exhibit J and ask you if you recognize it?
>
> "A. Yes, I do.
>
> "Q. What are those documents? Would you tell us, please?
>
> "A. This is a listing of 175 previously mentioned affairs that were not entered, that came from the appointment book, that were entered in other records.
>
> "Q. Who prepared the document?
>
> "A. I did.

***

"MR. PALMER: I would offer Department's Exhibit J into evidence.

"MR. RICHARD (for Estate of James Manno): You want to make the letters as part of that exhibit also?

"MR. PALMER: I'd like to have these marked for identification. Give them to Mr. Safran, he can tell us what they are.

"MR. RICHARD: Mark them as the same.

"HEARING OFFICER: We're also marking for identification two folders of letters which will be part of Exhibit J for identification.

"Q. I show you the two file folders containing documents which have been marked as State's Exhibit J and ask you what they are?

"A. These are replies from the parties contacted.****"

"Q. Let me interrupt you so that we can get this into evidence.

"MR. RICHARD: They are marked.

"MR. PALMER: I will have them marked into evidence.

"HEARING OFFICER: Back on the record.

(Exhibit J for identification now received in evidence as of this date.)"

(Transcript of Administrative Hearing, Dec. 3, 1986; Record, pp. 59-62)

Obviously the time when the auditor had just received the 30 contract-receipts, with the audit still under way and the books of account on the ready, was the time, if the requirements of procedural due process were to be satisfied, to furnish Manno with photocopies of these 30 receipted contracts and thus enable him to put them into whatever controlling use they could exert in the case. Respondents and their auditor had deprived the vendors of a due process opportunity to which they had been entitled.

The consequences of this breach of procedural due process are far ranging. No matter how strong the evidence in this case of the vendors' receipt of funds subject to sales tax, absent affir-

mative evidence of concealment, tax evasion, fraud or non-payment of sales taxes there should be no assessment therefor against these vendors.

b) With regard to the remaining 105 interviewees, the violation of substantive due process is clear. Here the auditor, as with the more "cooperative" 55 interviewees, chose to rely on whatever evidence he could gather from direct interviews with these persons who had booked reservations in the appointment book but for whom neither receipted contracts in the monthly folders nor red ink cancellations in the appointment book could be found. All of these people, without exception, as the unwitnessed auditor would have it, elected not to discuss the facts of their particular case but nevertheless did not deny that their particular affair took place. This strange formula, never characterized as affirmative speech coming from the mouths of any of these 105 "hostile witnesses" is monotonously repeated as a formula by the auditor in his Field Audit Report (Appendix 4, p.19a), the Decision of the Tax Commission, Appendix 3, p. 10a), and the Opinion of the Appellate Division, Appendix 2, p. 3a), all with the result of assessing sales tax on account of the 105 together with the 55 plus the 15 who could not be contacted, all plus a further projection of 1 year, 9 months raising the tax base to a total of over $800,000.

If, in the case of the 55 interviewees, the underlying fallacy was that proof of payment without a receipted contract therefor in the monthly folders was necessarily proof of tax fraud and concealment, the case of the other 105 interviewees rests on yet another underlying fallacy, this one more subtly implicit and never explicit. Because, reasoned the auditor, he found cancellations of booked affairs endorsed in red ink on the particular reservation space in the appointment book and covered over with a clear insert to allow for a new booking in that space, to him it followed that *all* entries in the appointment book not bearing the indicia of cancellation necessarily went on to become consummated affairs with payment in full at least 5 days in advance. While not a shred of evidence supports that proposition, it surely made the auditor more comfortable to ignore everything that these 105 "uncooperative witnesses" had to say in favor of his authoritarian intuition that, by their

silences, these people were not denying that a necessarily paid-for affair actually took place.

Lest this becomes a too easy solution for the revenue needs of many States, or any other jurisdictions for that matter, we feel it would be well for this Court to take this case under review.

Both the strongest statement of respondents' position and the immediacy of petitioners' attack upon it as "evidence," is at the evidentiary administrative hearing of December 3, 1986 (Record, pp. 109, 110):

> "THE WITNESS: 105 of that 120 people were contacted. Of the 105 some may not have been contacted. I am not sure of the exact number, but there was enough information in the appointment book to generate a dollar figure for a sale amount. The remaining 15 were estimated based on all of the other 160.
>
> "Q. Without a confirmation you are assuming that this event took place?
>
> "A. That's correct. As I testified earlier.
>
> "HEARING OFFICER: You answered the question.
>
> "THE WITNESS: As I testified earlier, no one that we contacted denied that the affair took place.
>
> "Q. And along with that statement, where you said that no one denied that the affair took place, with that information, you assumed that the affair did take place from a negative response you are making a positive calculation?
>
> "A. It was not a negative response.
>
> "Q. If you said no one denied that the events took place, now I don't know whether you asked them a question and there was no answer, no response, but you are taking that negative response as a positive answer for your calculations?
>
> "A. It was not a negative response. What it was, it was a response indicating that they did not want to get involved. People do not like to talk to the Tax Department. It would be normal for a person to say what affair. No one said that."

If the diaphanous state of the "evidence" related by the auditor still leaves us wondering how to cope with the strong and dogmatic utterances of the agency and its auditor,

> "The cancellation of an event was also noted in the appointment book. *** all the contracts in the file were revealed in the cash receipts journal and cancelled contracts were indicated as such in the appointment book." (Decision of the State Tax Commission, Appendix 3, p.10a)

and,

> "If the affair gets cancelled, the cancellation is duly noted, in red ink, on the appropriate grid space. An index card is then attached over the space so that the room can be rebooked." (Field Audit Report, Appendix 4, p.18a)

But the auditor has himself spoiled the rigid delusion,

> "Q. *** would you continue please, Mr. Safran?
>
> "A. So what was done, we went page by page, day by day, for the two-year period 9/1/81 through 8/31/83, and where those affairs were listed, we checked to see if the information, the sale was entered in their sales book and their cash receipt book, and we noted that if the sale was cancelled, it was actually marked *sometimes* and an index card would be placed over a cancelled sale, so that place could be rebooked. ***" (Transcript of Hearing, 12/3/86, Record, p. 64) (emphasis supplied)

And here it is worth noting that the effect of the word "sometimes", is that if a practice is "sometimes" observed, "sometimes" it is not. And a reservation running out of time may be allowed to do just that without further ceremony. Admittedly, the appointment book is a schedule of operations rather than a book of account. Tended and with entries made by banquet managers, pragmatic rather than esthetic considerations are obviously the rule. Thus, the testimony of the auditor:

> "MR. BLITZER [petitioners' accountant]: Is the appointment book part of the original books of entry?
>
> "THE WITNESS: I don't believe so.
>
> "MR. BLITZER: Did you ever ask who put entries in the appointment books?

"THE WITNESS: I did not ask directly, but I noticed the people that were banquet managers were utilizing such books." (Minutes of Administrative Hearing, Dec. 3, 1986; Record, p. 100)

and in the course of that hearing at Record, p. 84:

"Q. Did you ask anybody who made the entries in the appointment book?

"A. From what I saw in the appointment book, it appeared evident to me that there were various banquet managers that were making the entries in the appointment book and I recall on several occasions seeing banquet managers or I believe that was their title, looking through appointment books, perhaps for the future."

And finally, implicit in the procedural due process violation tainting the failure of respondents to afford petitioners timely opportunity to inspect and make use of the potential significantly defensive documentary material represented by the 30 hitherto missing receipted contracts, even ultimate proof that the 105 "non-cooperative" witnesses had indeed made final payment for the affairs they had booked, could not, without affirmative proof of actual evasion of tax payment to the tax authorities, be assessed against the petitioners.

Clearly, from the time the constitutional issues of this case could be discerned—violation of procedural due process with respect to the 30 incoming receipted contracts, and violation of substantive due process on the part of the 105 "uncooperative witnesses," and the auditor's dispensing with evidence in this aspect of the case, these constitutional issues were consistently pressed by petitioners at the very next hearing opportunity as the controlling issues of the sales tax case.

STATEMENT PURSUANT TO RULE 14(h) OF THE SUPREME COURT RULES

Our objections here, as they were in the two State courts which entertained this matter, is that the assessment of the New York State Sales Tax was violative of the due process clause of the Fourteenth Amendment of our federal Constitution, procedurally with respect to the 55 customer witnesses admitting payment for their consummated affairs, with 30 of them submitting their receipted contracts therefor to the auditor, and,

substantively with respect to the 105 interviewed people who had booked reservations on the appointment book, but who, in the words of the auditor, refused to say anything affirmative of the reality of the booked affairs coming to pass, or having made the required payment in advance for them, or having any receipted contracts for them, but nevertheless, and again in the auditor's words, "not denying" that their booked affairs had indeed been celebrated. We regard these constitutional objections, as we regarded them in the State courts, as controlling of the respondents' sales tax case, and we pressed these vigorously and timely in the Appellate Division and in the Court of Appeals.

The uncovering of what we regard as constitutionally objectionable conduct on the part of respondents came out in the administrative hearing of December 3, 1976 where both the 30 receipted contracts were first revealed to petitioners; and the State auditor testified to the methodology for concluding that the 105 "uncooperative witnesses" had, in their silences, "not denied" the actuality of their booked affair coming to pass, and thus justifying the sales tax assessment on account of these 105. The State Tax Commission agreed with both the autitor's reasoning and his assessment (Decision of the Commission, June 18, 1987; Appendix 3). Accordingly, by letter of June 18, 1987, the Tax Commissioner advised petitioners:

> "Please take notice of the Decision of the State Tax Commission enclosed herewith.
>
> "You have now exhausted your right of review at the administrative level. *** a proceeding in court to review an adverse decision by the State Tax Commission may be instituted only under Article 78 of the Civil Practice Law and Rules; and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 months from the date of this notice. ***"

This case was indeed timely instituted in Supreme Court, Albany County, but, under the provisions of New York's CPLR §§7803(4) and 7804(g)(pp. 2,3) was transferred to the Appellate Division, Third Department. Thus the opinion of the Appellate Division herein of January 9, 1989 (Appendix 2, p. 2a):

> "Proceeding pursuant to CPLR article 78 (transferred to this court by order of the Supreme Court, entered in Albany County) to review a determination of respondent which sustained a sales and use tax assessment imposed under Tax Law articles 28 and 29."

This statutory transfer to the Appellate Division is significant for many reasons, not the least of which is that, *pro hac vice,* the transferee court is transformed into a court of original rather than appellate jurisdiction, and notions of opportunities lost because first raised "on appeal" while the actuality is that the transferred case is still in a court of original jurisdiction can and do stifle rights, including constitutional ones. More, unless the highest Court of the State grants discretionary permission to appeal or retains a case in honor of its statutory obligation to accord to an appellant an appeal as of right in cases directly involving constitutional questions, a litigant suffering an adverse result from a transferee court, may very well have suffered a forfeiture of an otherwise secure right to appeal notwithstanding the constitutional implications of such a forfeiture.

In practice, as with motions for summary judgment, New York Article 78 proceedings tend to be tried on paper, and the judicial trial technique with direct and cross-examination of witnesses tends to be rare.

Still, however imitative of appellate procedure an original jurisdiction judicial review of administrative proceedings featuring an evidentiary hearing may be, a court exercising original jurisdiction ought not to be able to throw out as "untimely" any attempt in the course of that original judicial proceeding, to introduce matter which, unless it is brought up in the course of that original proceeding, is in danger of being forever lost to the litigant relying on it as "untimely." Constitutional guarantees are entitled to be enforced rather than bypassed.

Once the case was transferred to the Appellate Division, petitioners' exchange of briefs with respondents' made it clear beyond peradventure that precisely the same 14th Amendment due process objections as are here advanced constituted the whole of petitioners' attack on the administrative assessment of the sales tax, viz., 1) violation of procedural due process with respect to respondents' suppression of the quintessentially im-

portant 30 receipted contracts received directly from interviewed customers, a suppression which effectively blocked petitioners from access to a potentially conclusively effective defense, and 2) violation of substantive due process in assessing additional sales tax on the basis of 105 interviewees who furnished no evidence whatsoever to support that assessment.

Thus our main brief to the Appellate Division with its two point headings concerning imposition of the sales tax assessment:

"Point I

"WHERE PROOF OF PAYMENT SUBJECT TO SALES TAX IS UNILATERALLY ADDUCED BY THE STATE TAX COMMISSION FROM 55 OUT OF 175 PUTATIVE CUSTOMERS IN AN ACTUAL AUDIT COVERING A TWO YEAR PERIOD, AND SUCH PROOF IS AS CONSISTENT WITH PROPER REPORT AND TAX PAYMENT BY AN INNOCENT VENDOR AS IT MAY BE WITH FRAUDULENT DIVERSION, IT IS A VIOLATION OF LAWFUL PROCEDURE, ARBITRARY AND CAPRICIOUS, VIOLATIVE OF CPLR § 7803 AND OF STATE AND FEDERAL CONSTITUTIONAL GUARANTEES OF PROCEDURAL DUE PROCESS, TO PROCEED TO AN ADMINISTRATIVE EVIDENTIARY HEARING, OR EVEN TO A DETERMINATION BY RESPONDENT'S AUDIT BUREAU, WITHOUT HAVING GIVEN THE VENDOR PRIOR OPPORTUNITY TO AT LEAST CONFRONT AND ACT UPON THE DOCUMENTARY EVIDENCE SO ADDUCED OR AVAILABLE, *e.g.*, PHOTOCOPIES OF THE 30 RECEIPTED CONTRACTS RECEIVED BY THE TAX AUDITOR AND PHOTOCOPIES OF BOTH SIDES OF CANCELLED CHECKS USED IN PAYMENT BY ANY OF THE 55 CUSTOMERS."

"POINT II

"SUBSTANTIAL EVIDENCE DOES NOT SUPPORT THE DETERMINATION OF RESPONDENT, AFTER EVIDENTIARY HEARING, THAT PETITIONER

OUGHT TO BE ASSESSED SALES TAX, INTEREST AND PENALTIES WITH RESPECT TO THE 105 "UNCOOPERATIVE WITNESSES" WHO, BY THE AUDITOR'S ACCOUNT, UNANIMOUSLY REFUSED TO CLAIM PAYMENT FOR ANY AFFAIR, FURNISH ANY PROOF OF PAYMENT, NOR AFFIRMATIVELY CLAIM THAT THE AFFAIR WHICH THEY HAD BOOKED HAD ACTUALLY TAKEN PLACE, PLUS THE 15 WHO DID NOT EVEN RESPOND TO THE AUDITOR'S COMMUNICATION AND THE ADDED PROJECTION MADE THEREFROM."

With regard to Point II, our main brief unequivocally stated the coincidence of statutory (CPLR, §7804(g); p.3) and constitutional due process in this case:

> "***when the auditor contacted people*** whose answers were contrary to what he would have liked to have heard, it does not follow that, by branding witnesses as 'uncooperative' because while indicating familiarity with the affairs they booked, they still refused to say affirmatively that their contracted affairs were actually celebrated and that they paid the price which is the *sine qua non* for any affair, the respondent could then soak the vendor the same as though the imaginary affair were real and then, by projection, virtually double the confiscation. We believe this forfeiture not only goes beyond the bounds of *Chartair, Inc. v. State Tax Commission, 65 AD2d 44 (3rd Dept. 1978), but violates the substantive due process of both State and federal constitutions." (Ptnr. Main Brief, p.8). (Emphasis supplied)*

Notwithstanding their contentions that one must be as quick as lightning to save a constitutional point, and must also somehow object to the admission of documentary exhibits with which one is agreeable and to which one has no objection at all, the Brief of respondents to the Appellate Division had the good grace to admit that the thrust of our case was constitutional. Thus:

> "Petitioners contend that the State Tax Commission

determination is not supported by substantial evidence, that they had a right to have their total sales and use tax liability established based upon their actual records, instead of an unconsented to projection and that their right to due process of law was violated at the hearing. These contentions as hereafter shown are without merit.

"Initially, we note that petitioners' claim of denial of due process of law with respect to the admission of customers' letters and receipted contracts (responding to the auditors' inquiries) was not raised in the pleadings in this proceeding or at the administrative hearing (Petr Br, pp 29-32). Accordingly, it is not properly before this Court for review. *Matter of Haz-O-Waste Corp. v. Williams,* 103 AD2d 1001 (4th Dept 1984). Moreover, petitioners' representative at the hearing agreed to the admission of the customers' letters and receipted contracts (Exh J; original exhibit handed up with this brief [R62]), which they now claim violated their right to due process of law because of prior non-disclosure (Petr Br, p 32). Clearly, petitioners have waived their rights by failing to raise the issue at the time of the hearing when it could have sought an opportunity to rebut the evidence. Under such circumstances, there is no due process violation. *Cf. Matter of Geddes v. Wilmot,* 111 AD2d 474 (3rd Dept 1985), *lv denied* 66 NY2d 603 (1985), *app dsmd* 66 NY 2d 914 (1985); *Matter of Johnson v. Jones,* 119 AD2d 906 (3rd Dept 1986)." (Resp. Brief to Appellate Division pp. 8,9)

To which petitioners, in their Reply Brief to the Appellate Division, said, at p.2:

"***we feel that the respondent's brief has made considerable prejudicial distortion of the fact situation to which this CPLR Article 78 proceeding is addressed and raised arguments urging a preclusive bar to merit consideration of our constitutional due process and statutory procedural objections to the Commission's handling of highly material documentary evidence furnished by customers in response to requests for the same by government representatives.

"To the foregoing, this brief will make reply. And,

with respect to the Commission's preclusive effort, we will endeavor to show

> "1) That, in this judicial forum where this Court sits in an exercise of original rather than appellate jurisdiction, the constitutional and statutorily procedural objections were open to the petitioner to make under the general issue. And, if such is not the case, we respectfully move this Court, here and now to amend our petition to allege facts out of which said constitutional and statutory procedural objections arise***." Petnr. Brief, p.2

Blissfully unaware that, at the trial level, pleadings could not be amended to conform to proof, we also could not discern why, to save our due process point, we were obliged to object to the admission of documents which we felt we were entitled to inspect and copy three years before. Thus:

> "It would make no sense for the petitioner to object to the admission of Exhibit J (b) which contained the precious customer-submitted receipted contracts upon which were to rest our due process claim of Manno's right in the course of the audit to have been given access to them to enable him to prepare one of his most vital defenses, and to say that failure to object was a waiver of that due process point is, of course, utter nonsense."(Petnr. Reply Brief to Appellate Division, p.11)

Yet the Appellate Division, sitting in original jurisdiction of the case, took up respondents' theory lock, stock and barrel; Appendix 2, Appellate Division Opinion, p.3a, 4a.

> "Initially, we reject petitioners' argument that they have a right to have their tax liabililty established by their actual records and that their right to due process of law was violated by the auditor's resort to outside sources. A claim of denial of due process which was not raised in the pleadings or at the administrative hearing, as here, cannot be raised for the first time in this court (*see, e.g., Matter of Koren-Di Resta Constr. Co. v State Tax Commn.,* 138 AD2d 909, 911, *lv denied* 72 NY2d 805; *Matter of Haz-O-Waste Corp. v. Williams,* 103 AD2d 1001). Furthermore, petitioners failed to object to the admission of the

documents in issue. Accordingly, this claim has not been preserved for our review.

"We also reject petitioners' claim that the determination is unsupported by substantial evidence. When, as here, the taxpayer's records are insufficient, respondent must select a method reasonably accurate to assess the taxes due (Tax Law § 1138 [a] [1]; *see, e.g., Matter of Meskouris Bros. v. Chu,* 139 AD2d 813, 814, 815). The taxpayer must then establish by clear and convincing evidence that the audit method or tax assessment is erroneous (*see, e.g., Matter of Bonanno v. State Tax Commn., AD2d [Dec. 1, 1988]). Respondent's determination must be confirmed if there are any facts or reasonable inferences from the facts supporting the determination (see, e.g., Matter of Finserv Computer Corp. v. Tully,* 94 AD2d 197, 200, *affd* 61 NY2d 947)."

1. Manifestly the foregoing represents a refusal by the Appellate Division to deal with our constitutional objections on their own terms, which plainly charged procedural violation of due process in respondents' suppression of highly material documentary evidence produced by 30 of the 55 interviewed customers affirmatively acknowledging the celebration and payment for their affairs, and violation of substantive constitutional and statutory due process in resting the case of the 105 "uncooperative witnesses", not on evidence supplied by them but rather on the auditor's fanciful conjectures of what they should have said.

2. And it is plain distortion to attribute our constitutional objections to a sequential phenomenon like "the auditor's resort to outside sources", while ignoring the direct respondents' conduct complained of.

3. Nor can the Appellate Division, sitting in original jurisdiction, legitimately say, "A claim of denial of due process *which was not raised in the pleadings *** cannot* be raised *for the first time in this court"* (emphasis supplied). Here an appellate court has manifestly slipped into the error of forgetting that it is trying a case rather than hearing an appeal from it.

4. Nor can the opinion's attempt to require petitioners, in the interest of saving their due process objections, to have objected to the entry into evidence on December 3, 1986 of

documents which should have been furnished to them nearly three years before in the early months of 1984 be justified on any rational basis.

5. And, finally, nothing can explain away the fact that the auditor having elected to elicit supportive evidence for the Commission's case by direct interview of persons who had booked reservations in the appointment book, but for whom no receipted contract could be found, could not, in the case of 105 of the interviewees, obtain any affirmative information of any taxable payments by any of the 105 to petitioners where payments alone were the taxable events.

Proceeding thereafter on a course which would maximize appeal opportunities, petitioners first moved the Court of Appeals of the State of New York for permission, wholly discretionary with that Court, to appeal to it. That Court denied permission and petitioners then made a timely appeal as of right to the Court of Appeals of the State of New York, contending that the case directly involved construction of the Constitution of the United States.

In our invited Comments to the New York Court of Appeals, seeking to have that Court retain jurisdiction of our case as appeal taken as of right because it directly involved constitutional issues, we wrote at p.1:

> "Both our briefs to the Appellate Division and even the Tax Commission's make no bones that our effort in the Appellate Division was directed to having the imposition of a sales tax assessment invalidated on constitutional grounds of violation of these vendors' 14th Amendment due process rights, both procedural and substantive, leaving the use tax remnants of the case unsupportable because tainted by consesequences flowing from the constitutional violations."

and at p. 6 of our Comments;

"If it stands, the result below will be a triumph for preclusive treatment which could contribute to making a mockery of our precious constitutional rights,***"

And the counter Comments of the respondents, whose inane insistence on the necessity for our having objected—as the only way of preserving our constitutional objections—to the ad-

mission into evidence at the administrative hearing of documents, viz., the 30 receipted contracts, to whose admission we had no quarrel and were, in fact, extremely helpful to our cause, is justified only by the success of that cynical tactic in the State courts, and at least leaves no doubt that the questions posed by the case were constitutional 14th Amendment due process questions:

"Hon. Donald M. Sheraw
Clerk of the Court
Court of Appeals
Court of Appeals Hall
Albany, New York 12207

Re: *Manno v. State of New York, State Tax Commission*

Dear Mr. Sheraw:

"This is in response to your letter of December 27, 1989 requesting comments concerning whether a substantial constitutional question is directly involved in this appeal. It is respondent's position that this appeal does not raise any constitutional question, and, accordingly, should be dismissed.

"The Appellate Division did not consider the merits of petitioners' claim that their right to due process of law had been violated by the admission of certain documents at the administrative hearing. It observed that petitioners' claim was not raised in the pleadings or at the hearing. Moreover, petitioners did not object to the admission of the documents at the hearing. Under the circumstances, the Appellate Division concluded that the claim had not been preserved for appellate review (slip opn, p 2).

"Clearly, that claim may not now be raised in this Court. This Court has held that a constitutional question with respect to the admissibility of evidence is not preserved for review where, as here, the petitioner has failed to object at the administrative hearing. *Matter of Leogrande v. State Liquor Authority,* 19 NY2d 419 (1967); compare, also, *Matter of Herman v. Blum,* 54 NY2d 677 (1981) and *Matter of Hopkins v. Blum,* 58 NY2d 1011 (1983). Since petitioner failed to preserve the issue, it is, we submit, beyond the Court's scope of review. *Matter of Mead v.*

Levitt, 74 NY2d 634 (1989)."

Very truly yours,

ROBERT ABRAMS
Attorney General

The February 20, 1990 Order of dismissal of the appeal by the New York Court of Appeals (Appendix 1, p. 1a), reading:

> "The appellants having filed notice of appeal in the above title and due consideration having been thereupon had, it is
>
> "ORDERED, that the appeal be and the same hereby is dismissed without costs, by the Court *sua sponte,* upon the ground that no substantial constitutional question is directly involved.",

cannot, of course, be deemed ultimately dispositive *per se* simply because it is the mandate of the highest Court of the State. In resolving questions of practice or substance of federal constitutional law, it is this Court and not any State tribunal which, in the event of conflict, has the last word.

ARGUMENT

This petition makes no claim to proposing any changes, additions to, or departures from what is fundamental in the concepts of Fourteenth Amendment due process of law. We feel that suppression by the State of non-privileged, material, documentary evidence having a manifest potential for merit bearing on the outcome of its case against private, defending litigants is here, with respect to the 55 customers furnishing the 30 receipted contracts, at least in *prima facie* violation of procedural due process, and should have mandated an appeal as of right.

And, with respect to the 105 "non-cooperating" witnesses, the statutory due process formula of CPLR §7803(4) requiring the administrative case to be "on the entire record, supported by substantial evidence," accords very well with federal authority on "substantial" as an implied quantum where supporting evidence is required. Thus *National Labor Relations Board v. Columbian Enameling & Stamping Co., Inc.,* 306 U.S. 292 (1939) where Stone, J. said at 299, 300:

"Section 10c of the [National Labor Relations] Act Provides '*** The findings of the Board as to the facts, if supported by evidence, shall be conclusive.' But as has often been pointed out, this, as in the case of other findings by administrative bodies, means evidence which is substantial, that is, affording a substantial basis of fact from which the fact in issue can be reasonably inferred. [citing cases]. Substantial evidence is more than a scintilla and must do more than create a suspicion of the existence of the fact to be established. It means such relevant evidence as a reasonable mind might accept as adequate to support a conclusion,' [citing cases], and it must be enough to justify, if the trial were to a jury, a refusal to direct a verdict when the conclusion to be drawn from it is one of fact for the jury. [citing cases]."

And here again, New York State law is in accord; thus *54 Cafe & Restaurant v. O'Connell,* 274 App. Div. 428; 84 N.Y. Supp. 2d 729 (1st Dept. 1948) affd. 298 N.Y. 883; 84 N.E. 2d 802 (1949) where Shientag, J. said:

"While courts are loathe to interfere with determinations of administrative agencies made in good faith, they have by no means abdicated their judicial responsibility to review and pass upon administrative action claimed to be arbitrary and without foundation in fact or in law. A finding of an administrative agency 'is supported by the evience only when the evidence is so substantial that from it an inference of the existence of the fact found may be drawn reasonably.' *Matter of Stork Restaurant v. Boland,* 282 N.Y. 256, 273. *Insufficient evidence, it has frequently been held is, in the eyes of the law, no evidence. Matter of Case,* 214 N.Y. 199, 204." (emphasis supplied)

If neither far ranging novelty nor establishing new vistas in the fitting of Fourteenth Amendment due process protections to State action is the objective of this petition, we do think it is important for this Court, from time to time, to proclaim and enforce the vitality of due process. And we do think that unless this Court devotes some of its precious time to that purpose, the States and their agencies will tend to cut corners and avoid lines of investigation which may possibly vindicate the taxpayer.

Thus at the administrative hearing of December 3, 1986, Record, pp. 82, 83:

> "Q. Was Mr. Manno with you when you went through this Appointment book?
>
> "A. [Mr. Safran] No, he was not.
>
> "Q. Did you ever ask him questions about the appointment book?
>
> "A. Not about the appointment book.
>
> "Q. Why not?
>
> "A. Because I felt at that time if he knew that I had looked at the appointment book, I might never have seen it again.
>
> ***
>
> "Q. Was it always there when you were there?
>
> "A. Yes, it was.
>
> "Q. So it didn't disappear?
>
> "A. No, sir.
>
> ***"

With an audit run so freely on surmise; and projected yet further on totally unsupported theses lacking any data whatsoever, it is not surprising that the respondents came to the conclusion that they had unearthed

> "*** total unreported sales for the audit period of $827,078.00 with sales tax due thereon ***" (Decision of State Tax Commission, Appendix 3, p.11a),

and felt that

> "Due to the fact that gross sales were increased by $827,078 for the three and three-quarter year audit period, and [sic!] income tax audit is strongly recommended. Both form DO 1637 and form DO 1648 indicate an exchange of audit information. ***" (Field Audit Report, Sept. 18, 1984; Appendix 4, p.22a)

Interestingly enough, neither the federal nor the State income tax authorities have acted on that strong 1984 recommendation.

And finally, in wry response to respondents' assertion that we had lost our right to urge our constitutional objections by failing, at the administrative hearing of December 3, 1986, to

object to the admission of the documents (30 receipted contracts and customers' correspondence, hitherto suppressed and withheld from us, all constituting Exhibit J(b) to that hearing) we quote from a Ms. Sivteton's note, endorsed at the foot of the auditor's letter of inquiry and coming out of that Exhibit:

> "The dinner I had plan didn't take place. Please check your record. I had that date book but it never took place.
>
> Thank you,
> s/ Ms. Curline Sivteton"

Notwithstanding Ms. Sivteton's negative response, apparently to the auditor she was just another "hostile witness," and so he assessed a round $1,900. for her imaginary affair and, in projecting for an additional 21 month undocumented period which had been tacked on to the actual 24 months of appointment book entries, added another, round, $1,900. of assessment making a total of $3,800 base for sales tax assessment plus interest and penalties (Record, p. 262, 2d entry from bottom).

CONCLUSION

For the foregoing reasons, petitioner prays that this petition for a writ of certiorari be granted.

Respectfully submitted,

CARL N. MIONE,
Counsel for Petitioners
32 Court Street
Brooklyn, NY 11201
(718) 875-5537

Dated: May 11, 1990

APPENDIX 1—ORDER OF NEW YORK COURT OF APPEALS DISMISSING PETITIONERS' APPEAL, FEBRUARY 20, 1990

State of New York
Court of Appeals

At a session of the Court, held at Court of Appeals Hall in the City of Albany on the twentieth day of February A.D. 1990

Present, HON. SOL WACHTLER, *Chief Judge, presiding.*

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3 Mo. No. 180 SSD 10

In the Matter of the Estate of James Manno et al.,
Appellants,

v.

State of New York, State Tax Commission,
Respondent.

The appellants having filed notice of appeal in the above title and due consideration having been thereupon had, it is

ORDERED, that the appeal be and the same hereby is dismissed without costs, by the Court *sua sponte,* upon the ground that no substantial constitutional question is directly involved.

s/ Donald M. Sheraw
Donald M. Sheraw
Clerk of the Court

APPENDIX 2—OPINION OF THE SUPREME COURT OF THE STATE OF NEW YORK, APPELLATE DIVISION, THIRD DEPARTMENT, DISMISSING PETITION, FEBRUARY 9, 1989, 147 AD2d 805; 537 N.Y. Supp. 2d 683

Supreme Court—Appellate Division
Third Judicial Department

February 9, 1989 57419

In the Matter of the ESTATE OF JAMES MANNO et al.,
Petitioners,

v

STATE OF NEW YORK, STATE TAX COMMISSION,
Respondent.

MAHONEY, P.J.

Proceeding pursuant to CPLR article 78 (transferred to this court by order of the Supreme Court, entered in Albany County) to review a determination of respondent which sustained a sales and use tax assessment imposed under Tax Law articles 28 and 29.

James Manno and his brother, petitioner Dominick Manno, conducted Astorian Manor as a catering business in Queens County. The business was operated as a partnership through February 28, 1981. From March 1, 1981 through November 30, 1983, James Manno acted as a sole proprietor, and he died on May 5, 1984. In 1983, the Audit Division of the Department of Taxation and Finance conducted an audit of the sales and use taxes paid by Astorian Manor for the period March 1, 1980 through November 30, 1983. It was determined that sales and use taxes of $111,427.33 (not including penalties and interest) were due, and notices of determination and demand were issued. Petitioners made timely application to respondent to set aside the assessment.

A hearing was held at which the Audit Division's primary auditor agreed to reduce the tax due on expense purchases and fixed assets. With reference to the sales tax, however, the auditor, while agreeing that total sales as stated in petitioners' books were in close agreement with Federal tax returns and State sales tax returns, nevertheless described that petitioners' books and records were wholly inadequate in that they failed to record numerous affairs. As a result of petitioners' record deficiencies, a two-year analysis was done of petitioners' appointment book to see if the affairs listed in the appointment book were listed in the sales and cash receipt book. The Audit Division found that 175 affairs were listed in the appointment book but nowhere else. To check on these unrecorded affairs, the Audit Division sent letters or made field visits or telephone calls to the customers who contracted for the affairs. Of the 175 affairs, 30 were verified by actual contracts, 25 were verified by oral or written statements and 105 were estimated by appointment book notations because the individuals involved, while not denying that the affair took place, refused to cooperate. The prices of the remaining 15 affairs were determined by averaging the sales prices of the aforementioned 160 affairs. Based on this methodology, the Audit Division projected the two-year analysis for the entire audit period and determined that sales tax was due on $827,078 in sales for the entire period.

Respondent, in keeping with the primary auditor's agreement, reduced the tax due on expense purchases and fixed assets. Respondent further concluded that the sale tax returns were erroneous because of underreported sales, upheld the test audit because of inadequate records and fixed petitioners' sales tax due at $67,449.41. Petitioners then commenced this CPLR article 78 proceeding to set aside the notices of sales and use tax assessment for the periods March 1, 1980 through February 28, 1981 and March 1, 1981 through November 30, 1983. Supreme Court transferred the proceeding to this court.

Initially, we reject petitioners' argument that they have a right to have their tax liability established by their actual records and that their right to due process of law was violated by the

auditor' resort to outside sources. A claim of denial of due process which was not raised in the pleadings or at the administrative hearing, as here, cannot be raised for the first time in this court (*see, e.g., Matter of Koren-Di Resta Constr. Co. v. State Tax Commn.*, 138 AD2d 909, 911, *lv denied* 72 NY2d 805; *Matter of Haz-O-Waste Corp. v. Williams*, 103 AD2d 1001). Furthermore, petitioners failed to object to the admission of the documents in issue. Accordingly, this claim has not been preserved for our review.

We also reject petitioners' claim that the determination is unsupported by substantial evidence. When, as here, the taxpayer's records are insufficient, respondent must select a method reasonably accurate to assess the taxes due (Tax Law §1138[a][1]; *see, e.g., Matter of Meskouris Bros. v. Chu*, 139 AD2d 813, 814-815). The taxpayer must then establish by clear and convincing evidence that the audit method or tax assessment is erroneous (*see, e.g., Matter of Bonanno v. State Tax Commn.*, __ AD2d __ [Dec. 1, 1988]). Respondent's determination must be confirmed if there are any facts or reasonable inferences from the facts supporting the determination (*see, e.g., Matter of Finserv Computer Corp. v. Tully*, 94 AD2d 197, 200, *affd* 61 NY2d 947).

In this case, respondent's audit revealed that petitioners' books and records did not include all of Astorian Manor's sales, thus preventing an assessment based on actual sales. The two-year analysis revealed that 175 sales were recorded in petitioners' appointment book but not recorded in their sales record. To support the allegation that the books and records were incomplete, 55 documents representing contracts and receipted letters were introduced. This proof went largely unrebutted at the hearing. Thus, the only evidence in the record is that petitioners' records were incomplete and inaccurate, thereby allowing an estimate of additional taxes pursuant to Tax Law §1138(a)(1) (*see, Matter of Grecian Sq. v. New York State Tax Commn.*, 119 AD2d 948, 949-950). In the absence of clear and convincing evidence by petitioners that the audit method or the tax was erroneous, the sales tax assessment must be upheld

(*Matter of Urban Liqs. v. State Tax Commn.*, 90 AD2d 576, 576-577). Petitioners' reliance upon *Matter of Chartair, Inc. v. State Tax Commn.* (65 AD2d 44, 46-47) is misplaced. This simply is not a case where petitioners have the right to an audit based upon their own well-kept, comprehensive records.

Finally, petitioners failed to establish that the assessment of the taxes on the expense purchases and fixed assets as conceded by the auditor was arbitrary or capricious.

Determination confirmed, and petition dismissed, with costs.

MAHONEY, P.J., KANE, CASEY, WEISS and LEVINE, JJ., concur.

APPENDIX 3—COVERING LETTER AND DECISION OF STATE TAX COMMISSION DENYING VENDORS' ADMINISTRATIVE PETITION TO STATE TAX COMMISSION, JUNE 18, 1987

STATE OF NEW YORK
STATE TAX COMMISSION
ALBANY, NEW YORK 12227

June 18, 1987

Estate of James J. Manno
and Dominick Manno d/b/a Astorian Manor
25-18 Astoria Blvd.
Astoria, NY 11102

To the Executor:

Please take notice of the Decision of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 1138 of the Tax Law, a proceeding in court to review an adverse decision by the State Tax Commission may be instituted only under Article 78 of the Civil Practice Law and Rules, and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 months from the date of this notice.

Inquiries concerning the computation of tax due or refund allowed in accordance with this decision may be addressed to:

NYS Dept. Taxation and Finance
Audit Evaluation Bureau
Assessment Review Unit
Building #9, State Campus
Albany, New York 12227
Phone # (518) 457-2086

Very truly yours,

STATE TAX COMMISSION

cc:
Taxing Bureau's Representative

Petitioner's Representative:
Ralph Blitzer
Gerstman, Blitzer & Gelfand, P.C.
111 Great Neck Rd.
Great Neck, NY 11021

APPENDIX 3 (cont.)—DECISION OF STATE TAX COMMISSION DENYING VENDORS' ADMINISTRATIVE PETITION TO STATE TAX COMMISSION, JUNE 18, 1987

STATE OF NEW YORK
STATE TAX COMMISSION

In the Matter of the Petition
of
ESTATE OF JAMES MANNO
AND DOMINICK MANNO D/B/A ASTORIAN MANOR
for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period March 1, 1980 through November 30, 1983.

DECISION

Petitioners, Estate of James Manno and Dominick Manno d/b/a Astorian Manor, 25-18 Astoria Boulevard, Astoria, New York 11102, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1980 through November 30, 1983 (File No. 55000).

A hearing was held before Arthur Johnson, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York on December 3, 1986 at 9:15 A.M. Petitioner appeared by Gerstman, Blitzer & Gelfand, P.C. (Ralph Blitzer, CPA). The Audit Division appeared by John P. Dugan, Esq. (Gary Palmer, Esq., of counsel).

ISSUE

Whether the Audit Division properly determined additional sales and use taxes due from petitioners based on an examination of available books and records.

FINDINGS OF FACT

1. Petitioners, Estate of James Manno and Dominick Manno d/b/a Astorian Manor, operated a catering business that prepared food and drink and furnished service personnel. The premises had ten banquet rooms which were used simultaneously for different affairs. The business was operated as a partnership through February 28, 1981. Thereafter, James Manno conducted business as a sole proprietor.

2. On June 11, 1984, as the result of an audit, the Audit Division issued two separate notices of determination and demands for payment of sales and use taxes due covering the period March 1, 1980 through November 30, 1983. The first notice was issued against the Estate of James Manno (deceased), Dominick Manno, et al, d/b/a Astorian Manor for the period of the partnership (March 1, 1980 through February 28, 1981) for taxes due of $27,790.29, plus penalty and interest of $20,909.98, for a total of $48,700.27. The second notice covered the period the business was operated by James Manno as a sole proprietorship (March 1, 1981 through November 30, 1983) and was issued against the Estate of James Manno (deceased) d/b/a Astorian Manor in amount of $83,637.04 for taxes due, plus penalty and interest of $38,115.97, for a total of $121,753.01.

3. James Manno executed four consents extending the period of limitation for assessment of sales and use taxes for the period March 1, 1980 through February 28, 1981 to June 20, 1984.

4. On audit, the Audit Division prepared a schedule of gross receipts by month from the cash receipts journal for the audit period. The gross sales were totalled for quarterly periods and found to be in agreement with the sales tax returns filed. Reported nontaxable sales for the period ending May 31, 1982 were verified by exemption certificates. The gross sales from the books and records were also in agreement with Federal income tax returns filed for the period of the partnership.

5. Petitioners maintained an appointment book wherein the banquet managers recorded pertinent information regarding a scheduled affair. This information included the following:

a) data and time of the affair
b) name, address and telephone number of the customer
c) number of guests
d) price per person
e) notations on meals, cocktail hour and equipment

The cancellation of an event was also noted in the appointment book. The Audit Division examined sales contracts for the period March 1, 1982 through August 31, 1982. The contracts were compared with the cash receipts journal and the appointment book. This procedure revealed that all the contracts in the file were recorded in the cash receipts journal and cancelled contracts were indicated as such in the appointment book. However, after cross checking the contracts with the appointment book, the auditor found that there were 57 affairs scheduled in the appointment book for which no contracts were in the file and the receipts from each such affair were not recorded in the cash receipts journal. Because of this discrepancy, the same procedures were followed for the period September 1, 1981 through August 31, 1983. This test disclosed that 175 affairs were scheduled in the appointment book and the receipts therefrom were not recorded in the books and records. The Audit Division contacted each of the customers by letter, telephone or personal visit using the information in the appointment books to verify that the affair took place. Thirty affairs were verified by an actual contract furnished by the customer. An additional 25 affairs were verified by either a written or oral statement from the customer. There were 105 individuals contacted who chose not to give information about the affair but did not deny that the affair took place. The Audit Division received no reply about the remaining 15 affairs and the information in the appointment book was incomplete. The sales generated by the 175 unrecorded affairs were determined as follows: The actual sale amounts were known for the 55 affairs

verified by contract or statement; the sales for the 105 affairs with complete notations in the appointment book were estimated based on the approximate number of guestsand price per person indicated in the appointment books; the sales for the 15 affairs for which there were incomplete notations were estimated using an average sales price of the previous 150 affairs. The total sales from the foregoing unreported affairs for the period September 1, 1981 through August 31, 1983 amounted to $440,179.95. In order to estimate sales for those periods that the appointment books were not examined, the Audit Division determined a separate percentage of increase of unreported sales over reported sales for such quarterly period to account for seasonal fluctuations in the catering business. The percentages of increase were applied to the applicable periods and derived total unreported sales for the audit period of $827,078.00 with tax due thereon of $16,638.37 for the period of the partnership and $50,811.04 under the sale proprietorship.

6. The Audit Division reviewed expense purchases for the period March 1, 1982 through May 31, 1982 to determine any use tax liability. Based on its analysis of the test period, the Audit Division assessed use taxes due of $24,344.07 for the entire audit period. A detailed review of fixed asset acquisitions disclosed taxes due of $19,633.85.

7. At the inception of the audit, petitioners' representative orally agreed to the use of a text period audit method for expense purchases and indicated that an agreement form would be signed when the audit was completed. Such an agreement was never executed and consequently, at the hearing the Audit Division conceded that the tax assessed on the expense purchases be reduced to $1,909.28, the actual amount found due for the test period. Additionally, the Audit Division conceded that the tax due on fixed assets should be reduced to $16,294.99.[1]

8. Petitioners argued that it was not proper for the Audit Division to estimate sales for the periods for which the appointment books were not examined.

9. Petitioners adduced no evidence of any nature to establish that the assessments were in any way erroneous.

CONCLUSION OF LAW

A. That section 1138(a)(1) of the Tax Law provides that "if a return when filed is incorrect or insufficient, the amount of tax due shall be determined by the tax commission from such information as may be available" and authorities, where necessary, an estimate of tax due "on the basis of external indices."

B. That the audit procedures followed by the Audit Division disclosed that petitioners' sales tax returns were patently erroneous in that gross and taxable sales were substantially underreported and clearly established the unreliabilty of petitioners' books and records. When books and records are unreliable, the use of external indices is permissible (*Matter of Korba v. State Tax Commission,* 84 AD2d 655). Because of petitioners' inadequate record-keeping, it was proper under section 1138(a)(1) of the Tax Law for the Audit Division to estimate additional taxable sales for certain periods without examining any additional books and records. (*Matter of Urban Liquors, Inc. v. State Tax Commission,* 90 AD2d 576).

C. That the Audit Division reasonably calculated petitioners' tax liability for the period March 1, 1980 through November 30, 1983 and petitioners have failed to show that the audit method or tax assessed was erroneous (*Matter of Urban Liquors, Inc. v. State Tax Commission, supra*).

D. That the petitions of the Estate of James Manno and Dominick Manno d/b/a Astorian Manor are granted to the extent of the adjustments conceded by the Audit Division in Finding of Fact "7"; the Audit Division is hereby directed to modify the notices of determination and demands for payment of sales and use taxes due issued June 11, 1984; and that, except as so granted, the petitions are in all other respects denied.

DATED: Albany, New York
JUN 18 1987

STATE TAX COMMISSION

s/ Roderick W. Chu
PRESIDENT

s/ Francis R. Koenig
COMMISSIONER

s/ Melvin Jackson
COMMISSIONER

APPENDIX 4—FIELD AUDIT REPORT, SEPTEMBER 18, 1984

STATE OF NEW YORK—DEPARTMENT OF TAXATION AND FINANCE
FIELD AUDIT REPORT - SALES TAX - ATTACHMENT SHEET

Field Audit Report 9/18/84 R. SAFRAN
119 QUEENS District Office Page 1 of 12 pages
ASTORIAN MANOR, Vendor
25-18 Astoria Blvd., Astoria, NY 11102
Identification Number 11-1791101 119-339-86

Include on this report detailed information on *Nature and Description of Business, Records Available, Audit Performed, Recommendations and Conclusions,* and *Vendor's Reaction.*

Prior to the inception of the physical audit work, representative (Power of Attorney submitted) was advised of the Tax Appeals Process.

Books and records were maintained at the vendor's place of business, where the certificate of authority was found to be prominently displayed. Such books and records were initially deemed adequate, but representative would only orally agree to test period methods, stating that he would sign a test period agreement (form AU-377-12) after the audit was completed. However, during the course of the audit, it was discovered that books and records were, in fact, inadequate to the extent that there was a potential for the existence of fraud with respect to unreported income. The following five (5) page report, which accompanied the AU-349 (referral of possible fraud) sent to our Albany Fraud Unit, details the preliminary audit work performed that led to our referral:

AUDIT REPORT—ASTORIA (N) MANOR

Vendor operates a catering hall in the Astoria section of Queens, New York, and has been in business since 1956. The hall has ten rooms which can and are utilized concurrently for ten different affairs, especially on weekends.

The business was conducted as a partnership through 2/28/81: James Manno, SS# 113-10-2830, partner and Dominick Manno (brother), SS# 113-10-2829, partner. Beginning with 3/1/81 and continuing through the end of the updated audit period; James Manno has conducted the business as a sole proprietor. Note that, although the print-out of vendor's sales tax filing records is headed "Astoria Manor", the corresponding sales tax returns are headed "Astorian Manor". There are also other instances of this difference in names, but vendor apparently uses both titles interchangably.

RECORDS MAINTAINED:

Vendor maintained a book captioned Cash Receipts, but, in actuality, it was a Sales Book. The amounts posted in this book came from contracts that were handed to the outside Junior Accountant by James Manno. Monthly totals were then posted to a General Ledger Account entitled Catering Income. Columns in this account are headed:

Column 1). Total
2). Liquor and Beer
3). Food
4). Hat Check & Misc.
5). Cancelled Contracts
6). (Not Used)
7). Rental Income

2 and 3 are just estimated breakdowns of sales for insurance purposes. Both 2 & 3 are subject to sales tax.

4 Hat Check and Miscellaneous is subject to sales tax.

5 and 7 are *not* subject to sales tax.

AUDIT PERFORMED:

A schedule was prepared for the period March 1, 1980 through November 30, 1983, showing the monthly Liquor &

Beer, Food, and Hat Check and Misc. amounts. The monthly figures were then totalled quarterly and compared to the gross sales reported on corresponding sales tax returns. (There were non-taxable affairs and a test of such affairs for the QE 5/31/82 found all to be supported by proper documentation). All differences (although minor and insignificant) were reconciled. Note that vendor is a part-quarterly (monthly) filer.

Gross sales per books, and sales tax returns were compared to Federal Income Tax Returns for the final partnership period of 1/1/81 - 2/28/81, and the two succeeding periods of individual proprietorship of 3/1/81 to 12/31/81 and 1/1/82 to 12/31/82. Differences found were attributable to several items (income from cancelled contracts, from rentals and commissions) not subject to sales tax that were not included in the gross sales reported on the corresponding sales tax returns. However, since these items have income tax implications, they were properly included on the appropriate income tax returns.

Purchases per books were compared to the Federal Return for the period 3/81 - 12/81 and the difference found was attributable to adjusting entries for accounts payable accruals and for transfers from a related corporation.

Vendor maintained two checking accounts: One for payroll and one for all other transactions. Per the Junior Accountant, the amount of monies deposited in the payroll account is determined by the owner, James Manno, based on James Manno's experience in this phase of the business. The procedure for cash collection, which is common in the catering industry, is as follows:

1. A deposit is made at the time the contract is written, or shortly thereafter.

2. The balance is substantially paid in full at least five days prior to the date of the affair.

3. Any last minute adjustments (plus or minus guests, or charges for additional time for the affair) that result in monetary changes are addressed the day of the affair.

The initial deposit (1) may be made in cash, by certified check, or by personal check. However, the final payment(s) (2 and 3) must be made in cash or by certified check. Again, this procedure is common in this industry.

A schedule of cash deposits was prepared from bank statements for the original audit period of 3/1/80 to 11/30/82. Total income from all sources was found to be higher than total deposits (both accounts) by $18,468. This amount represents only .15% (.0015) of total income (all sources) and is therefore considered insignificant.

Per discussions with the C.P.A., the Junior Accountant, and the owner, it was revealed that there were no cash payouts with everything being paid by check. Although contracts were imprinted with the terms "Service Charge Included," there was no evidence of any gratuities being paid by check. I asked Mr. Manno specifically about tips and he stated that there are none. I went further by asking if his waiters are paid better salaries than those that work at other catering halls where tips are handed out. He replied by saying that his employees serve to make the affairs as pleasant as possible for the customer and guests. If the customer wants to reward the employees (waiters, maitre D's, etc.), that's the customer's business. When I mentioned the possibility of cash payouts for tips, Mr. Manno stated again that there are no cash payouts.

Since there are ten rooms available and several banquet managers employed, an appointment book is maintained for the manager's use. It is a calendar year diary that, on Fridays, Saturdays (A.M. & P.M.), and Sundays (A.M. & P.M.), has a 2X5 grid of the ten rooms. These are the busiest days of the week and these grids serve to allow affairs to be booked in all available rooms simultaneously, without duplication. The notations in the book are as follows:

1. After the initial interview with the customer, the banquet manager enters the following in the appointment book on the date of the affair in the space on the grid corresponding to the room or rooms for this customer:

A). Banquet Manager's Name
B). Date that this Information is being Entered
C). Type of Affair
D). Time of Affair
E). Person(s), Address(es), and Telephone Number(s) of Customer(s)
F). Approximate Number of Anticipated Guests

G). Approximate Price per Person (will vary as changes are made and until contract is finalized)
H). Notations Regarding Meals, Cocktail Hour, Viennese Table, Etc.

2. If the affair gets cancelled, the cancellation is duly noted, in red ink, on the appropriate grid space. An index card is then attached over the space so that the room can be re-booked.

3. If the date, or the room of the affair is changed, such change(s) is (are) duly noted on the grid space and the information. (see 1A through H) is rewritten in the appointment book in the appropriate grid space. Again, an index card is attached over the space.

Note that, since Monday through Thursday are not very popular for affairs, the grid space method is not needed. On these days, notations as in 1A through H can be found, but there is no need for index cards to be used as indicated in 2 and 3.

As previously stated, vendor maintains a book captioned Cash Receipts but in actuality, it is a sales book. When the contracts are recorded, only the amounts are entered, the names are not.

After our test of non-taxable sales was completed for the quarter ended 5/31/82 (with no disallowance found), we performed the following auditing procedures with the sales contracts (which were filed monthly), the cash receipts book, and the appointment book:

Several 2X5 grids were prepared, similar to those found in the appointment book. An "X" was placed in a box where no affair took place, a "Y" was placed in a box where an affair took place and for which we had a contract (such contract was found in the cash receipts books; note that all contracts found in the monthly folder were found to be entered in the cash receipts book), and in any grid space left over, an "O" was entered, indicating an affair for which we had no contract and therefore no evidence of the income from that affair being reported. Note that cancelled contracts found in the monthly folder were traced in the appointment book to the dates they were originally scheduled for, and the cancellation was found to be duly noted in the appropriate grid space.

This procedure was also carried out for the QE 8/31/82 and the result of both quarters found approximately 57 affairs that were not recorded. Ultimately the procedure was used to cover the period 9/1/81 through 8/31/83. In all, there were approximately 175 affairs that were not recorded.

All pertinent information (names, addresses, telephone numbers, and details of the affair) was transcribed and the individuals were contacted by letter, by telephone call, or by personal field visit. No individual who was contacted denied that the affair took place (with the exception of disinterested parties contacted in error). In fact, many were cooperative to the extent that they supplied us with either copies of their contracts or statements (oral and/or written) that detailed the affair. A comparison of these contracts or statements with the appointment book notations verified the accuracy of such notations, with plus or minus variances (with respect to dollar amounts and number of guests) generally offsetting each other from one affair to the next. Therefore, where no contract or statement was available, a sale amount was projected, based on the appointment book notations. In total, there were thirty (30) affairs verified by contract, twenty-five (25) verified by statement, and one hundred five (105) projected from appointment book notations for a total of one hundred sixty (160) affairs that were not reported. Additionally, there were fifteen (15) affairs where replies from customers were not obtained and the appointment book notations were not complete. Sales generated from these affairs were determined by using an average amount based on the other 160 unreported affairs. The one hundred seventy five (175) unreported affairs were determined to represent unreported income of $440,179.95 for the period 9/1/81 through 8/31/83, which was the period where we physically examined the appointment books. Percentages of increase were determined for the quarter's ended 2/28(9), 5/31, 8/31 and 11/30 to cover the periods where there was no physical examination of appointment books. This procedure resulted in total additional taxable sales of $827,078 for the full audit period of 3/1/80 through 11/30/83.

Due to the potential for the existence of fraud, the "Committee" in Albany requested that James Manno, D/B/A

Astoria(n) Manor, be prosecuted under article 28, section 1145(b) of the New York State Tax Law for filing false and fraudulent returns. Pursuant to Section 63(3) of the Executive Law, Commissioner Roderick G.W. Chu requested that the Office of The Attorney General take whatever action deemed necessary for prosecution. However, shortly after Commissioner Chu's request was made, James Mano died as the result of a heart attack and therefore, no criminal prosecution was possible. Per discussions with Edmund S. Goldberg, Special Assistant to the Director of the Tax Department's District Office Audit Bureau, two assessment factors were revealed: Firstly, issue separate assessment documents for the period of partnership (3/1/80 through 2/28/81) and for the period of sole proprietorship (3/1/81 through 11/30/83) and secondly, assess statutory interest and penalty charges only; Do not assess fraud penalty since the surrogate court involved with James Mano's estate would overturn such fraud penalty charges. The sales tax due on the additional taxable sales of $827,078 amounted to $16,638.37 for the period of partnership and $50,811.04 for the period of sole proprietorship.

In addition to the examination of sales, expense purchases and fixed asset acquisitions were reviewed, in a routine manner, to determine the existence of any use tax liability. The months of March, April and May 1982 were assigned by team leader, agreed to by representative, and used by auditor as a test period for the examination of expense purchases. As previously stated, representative would not sign a test period agreement (form Au-377-12) until after the audit was completed. Due to the fraudulent nature of the case, we no longer had contact with the representative and therefore, the opportunity to sign the form never arose. During the period of time that the representative was in contact with us, he did voice his objection to our handling of transactions involving "Petro Fuel" in conjunction with the "light, heat, and power" account. He believed that it would not be correct to project a disallowance percentage because the correct tax rate may have been charged on earlier invoices (during the test period, vendor was charged and paid tax at the 4% N.Y.C. rate; tax should have been charged and paid at the 8¼% combined rate). The actual "Petro" payments were

transcribed for the period 3/80 - 12/82 and the payments for the remainder of the audit period, 1/83 - 11/83, were estimated, based on the actual amounts transcribed (cash disbursements were not available for that latter period). The corresponding invoices were requested but never presented, and it was therefore assumed that vendor was charged and paid tax continuously at the 4% NYC rate. Use tax due amounted to $3,416.88 (4% NY State) for the period of partnership and $9,890.00 (4% + 4¼% state) for the period of sole proprietorship on "Petro" purchases of $85,422 and $234,782 respectively.

Disallowances were found in the remaining portion of the "Light, Heat and Power" account as well as in the "Linen and Supplies" account, in the "Repairs and maintenance" account, and in the "Protection" account. Use tax due amounted to $2,137.28 at the 8% combined rate and $1.60 at the 4% NY City rate for the period of partnership and $14,037.69 at the 8% and 8¼% combined rate and $8.64 at the 4% NY City rate for the period of sole proprietorship.

Fixed asset acquisitions were reviewed for the audit period and it was determined that there were $69,952 of purchases subject to use tax for the period of partnership and $171,939 of purchases subject to use tax for the period of sole proprietorship. Use tax due at the statutory rates of 8% and 8¼% amounted to $5,596.16 and $14,037.69 for the two periods respectively. Note that, for the period 1/83 through 11/83, there was $40,471 of fixed assets acquisitions for which invoices had not been requested and use tax was assumed to be due. Adjustments are to be made if and when invoices are presented and tax is found to be paid, where applicable, or no tax is due, if exempt.

Due to the untimely death of James Manno and the impending expiration of a waiver (AU-2.10), assessments were issued by the Queens District Office on June 11, 1984 in the following manner:

Dominick Manno, Et. Al, D/B/A Astorian Manor for the period 3/1/80 - 2/28/81 in the amount of $48,700.27 (sales and use tax $27,790.29, penalty $6,947.58, statutory interest

$13,962.40) and Notice #S840611000C against the estate of James Manno (Deceased) D/B/A Astorian Manor for the period 3/1/81 - 11/30/83 in the amount of $121,753.01 (sales and use tax $83,637.04, penalty $17,746.67, statutory interest $20,369.30).

As of August 24, 1984, neither assessment has been protested. However, during a conversation with the representative, there were definite indications that protests would be forthcoming. Note that a new Power of Attorney, covering the estate of James Manno, was going to be submitted by the original representative. However, he subsequently stated that he is no longer involved in this matter at this time. A Power of Attorney had been submitted by a legal representative after the original representative was advised of the existence of the Potential for Fraud. Per conversations with Mr. Edmund S. Goldberg, it was revealed that a new Power of Attorney from this legal representative would be necessary, due to Mr. Manno's death. Copies of pertinent workpapers have been made, and will be sent to any party that so requests them, providing that a properly completed Power of Attorney form has been submitted.

Note that a Vendee Information Report (ST-510), included in the "Albany File", indicated that Astorian Manor had made a tax free purchase of tangible personal property with the use of a Capital Improvement Certificate. This transaction was addressed during the review of fixed asset acquisitions and use tax was assessed accordingly.

Vendor was complying with New York State withholding tax requirements and had filed form WRS-2. A tax compliance checklist (AU-249.2) was presented to representative for completion but it was never returned.

Due to the fact that gross sales were increased by $827,078 for the three and three-quarter year audit period, an income tax audit is strongly recommended. Both form DO1637 and DO1648 indicate an exchange of audit information. Also, a sales tax re-audit date has been indicated on form DO1637.

In summation, note that a great amount of investigative work was applied to this case by the auditor, team leader, and several other individuals.

The case was not pursued by the Attorney General's Office because of Mr. Manno's death. Due to the amount of additional tax and the substantiation we have that there were unreported sales it is strongly recommended that the full penalty and interest not be abated.

NOTE

The back up folder for the investigation work as summarized on p. 114 are in two expandable folders which will be kept with the main office file.

Examiner	Date	Approved by	Date
s/ Ronald Safer	9/17/84	s/Robert King	9/18/84